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David A. Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
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Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
rule-comments@sec.gov

Re: Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant"; Joint Proposed Rule (CFTC Definitions; SEC File No. S7-39-10)

Dear Mr. Stawick and Ms. Murphy:

Capital One Financial Corporation (together with its subsidiaries, "Capital One")[1] submits this letter in response to the Joint Notice of Proposed Rulemaking (the "Proposed Rulemaking") issued by the Commodity Futures Trading Commission ("CFTC") and Securities and Exchange Commission ("SEC" and, together with the CFTC, the "Commissions"), in consultation with the Board of Governors of the Federal Reserve System, to further define "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant" contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer

[1] Capital One Financial Corporation (www.capitalone.com) is a financial holding company whose subsidiaries, Capital One (Europe) plc, Capital One Bank (Canada Branch), Capital One, N.A., and Capital One Bank (USA), N.A., collectively had $122.2 billion in deposits and $197.5 billion in total assets outstanding as of December 31, 2010. Headquartered in McLean, Virginia, Capital One offers a broad spectrum of financial products and services to consumers, small businesses and commercial clients in the U.S., Canada and the UK. A top ten credit card issuer in the UK, Canada and United States and a Fortune 500 company, Capital One trades on the New York Stock Exchange under the symbol "COF" and is included in the S&P 100 index.

Protection Act (the "Dodd-Frank Act").[2] Capital One appreciates the opportunity to comment on these important definitions.[3]

Introduction

Capital One enters into swaps with large swap dealers to mitigate the risks of ordinary banking activities, such as hedging the interest rate and foreign exchange risks arising from its core lending and deposit-taking activities. Capital One also enters into swaps with its commercial banking customers in connection with loan origination and for hedging other interest rate and foreign exchange risks arising from their business operations. Capital One manages the risk exposure arising from each of these customer-facing swaps by entering into offsetting swaps with large swap dealers.

We participated in the preparation of the letter submitted by the Financial Services Roundtable on the Proposed Rulemaking and support the comments set forth therein, including its views on (i) unintended consequences that will arise from a narrowly defined *de minimis* exemption from the swap dealer definition, (ii) the importance of clarifying that the exemption from the swap dealer definition for banks in connection with loans extends to other provisions of credit by banks and (iii) other aspects of the swap dealer definition. We also support the Financial Services Roundtable's views on the definition of major swap participant, including its comments supporting the Commissions' proposals for further defining "substantial position" and "substantial counterparty exposure".

There are a number of areas of the Proposed Rulemaking that are of interest to Capital One. Therefore, we offer additional comments on the following areas:

- *Eligible Contract Participant ("ECP") Definition:* we propose a new category to the ECP definition that allows commercial end users to continue to effectively and economically hedge their loans and other extensions of credit with lender banks;

- *Lending Exclusion from the Swap Dealer Definition:* we propose that the lending exclusion explicitly include swaps entered into in connection with a loan for partial hedging, anticipatory hedging or subsequent hedging purposes;

- *Limited Swap Dealer Designation:* we support a registration process that provides all market participants an opportunity to request a limited swap dealer designation that would become immediately effective, on a provisional basis, at the time of registration; and

[2] *See* 75 Fed. Reg. 80174 (December 21, 2010).

[3] Capital One does not enter into security-based swaps, however, we are providing these comments to the SEC in connection with its coordinating role with the CFTC in further defining "Swap Dealer," "Major Swap Participant" and "Eligible Contract Participant," and adopting a timeline for implementation of Title VII of the Dodd-Frank Act.

- *Phased-In Compliance Period:* we support a flexible compliance period of at least 18 months so that small dealers are not severely disadvantaged relative to the largest and most active dealers, and commercial end users are not adversely impacted by the liquidity drain that would result if regional and local dealers halt their activities.

Capital One strongly supports a transparent and regulated derivatives market and commends the Commissions on their efforts to implement the provisions of the Dodd-Frank Act. We urge the Commissions, however, to exercise their statutory authority so that the key definitions of Title VII of the Dodd-Frank Act are implemented in a manner that minimizes the risk of unintended consequences for commercial end users and the lender banks that serve them.

Definition of Eligible Contract Participant

We appreciate the Commissions' request for comments on the ECP definition, including whether additional categories should be included in the ECP definition for commercial real estate borrowers and firms using swaps as hedges. Section 723(a)(2) of the Dodd-Frank Act makes it unlawful for an end user who is not an ECP to enter into a swap other than on a designated contract market ("DCM"). As a result, commercial end users who are not ECPs may not enter into a swap on a swap execution facility or a bilateral, off-exchange basis with a bank or other counterparty.

Prior to the enactment of the Dodd-Frank Act, commercial end user borrowers and their lender banks generally relied on the 1989 CFTC Policy Statement Concerning Swap Transactions (the "Policy Statement")[4] to enter into bilateral, interest rate swaps in connection with loans. The Policy Statement provided that individually negotiated swaps would not be subject to regulation as futures contracts under the Commodity Exchange Act (the "CEA") if a commercial end user entered into the swap related to its line of business and also satisfied other requirements. Community and regional bank borrowers are typically small businesses and partnerships who organize, primarily for tax and legal considerations, a limited liability company with a special purpose entity designation as the borrowing entity. As a result, these limited liability companies generally do not maintain sufficient capital at the borrowing entity level to qualify as ECPs. Instead, these borrowers rely upon the Policy Statement to enter into interest swaps on their loans with lender banks.

Title VII of the Dodd-Frank Act is inconsistent with the Policy Statement and restricts commercial end users' access to swaps. We urge the CFTC to address this problem by including an additional category in the ECP definition, as set forth in Section 1a(12) of the CEA, that permits commercial end user borrowers to continue entering into interest rate swaps in connection with obtaining loans or other extensions of credit with

[4] *See* Policy Statement Concerning Swap Transactions, 54 Fed. Reg. 30694 (July 21, 1989).

their lender banks, without the increased costs that would result from having to transact on a DCM. The CFTC possesses the authority under Section 1a(18)(C) of the CEA to include in the definition "any other person that the [Commodity Futures Trading] Commission determines to be eligible in light of the financial or other qualifications of the person."[5] We propose that the ECP definition specifically include any entity entering into a swap with a bank or other lending institution so long as the entity (i) is entering into a swap with the same firm that provided the loan or other extension of credit to the borrowing entity and (ii) the purpose of the swap is for the entity to convert the floating interest rate of its debt or credit product to a fixed-rate interest rate or vice versa.

If the CFTC does not include commercial end user borrowers as a new category in the ECP definition, the number of entities qualifying for bilateral, off-exchange interest rate swaps will be greatly reduced.[6] Those non-ECP end users who are prevented from entering into a swap on a bilateral basis with their lender bank will often pay a higher cost to enter into a swap with a non-originating bank dealer on a DCM. Commercial end user borrowers will incur greater costs from the higher credit risk premium assigned by a non-originating bank and the initial and variation margin requirements imposed by clearinghouses that otherwise would not apply if the borrower qualified as an ECP and was permitted to enter into a bilateral swap with its lender bank. Additionally, swaps transacted on a DCM may not offer the level of customization that commercial business end users require, forcing them to enter into multiple swap transactions with higher aggregate costs in an attempt to fully hedge their loan risks.

We also highlight that, while commercial end users who are not ECPs may access the swap market through DCMs, these exchanges will have only a small fraction of the number of counterparties who are willing to enter into customized, bilateral transactions on an off-exchange basis. Community and regional banks are motivated by their deep, existing banking relationships to provide commercial end users a swap that is customized to the terms of their related loan or other extension of credit. DCMs, on the other hand, generally will not offer highly customized swaps. The unavailability of customized swaps on the DCMs limits a commercial end user's ability to hedge its commercial risk. We ask the CFTC to include an additional category to the ECP definition so that commercial end users may continue to economically and effectively hedge their loans and other extensions of credit with their lender banks.

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[5] 7 U.S.C. § 1a(18)(C).

[6] The finance market for commercial real estate and other commercial and industrial enterprises generally consists of floating rate loans originated by banks. In many instances, a commercial end user hedges its floating rate loan by entering into an interest rate swap with a lender bank, thereby exchanging the floating-rate payments owed on its loan balance for fixed-rate payments. Banks of all sizes, ranging from community banks to regionals to the largest national banks, can provide this interest rate hedge to their customers on competitive terms due to their strong familiarity with the borrower and the ability as the lender bank to structure a related swap that is cross-collateralized by the loan collateral.

Swap Dealer Definition – Excluding Swaps in Connection with Originating a Loan

Capital One generally agrees with the CFTC's proposed implementation of the insured depository institution lending exclusion from the definition of swap dealer.[7] The CFTC requested comments on whether this lending exclusion should be limited to swaps entered into "contemporaneously" with the origination of a loan. We believe a time requirement would frustrate Congress' intent that commercial end users should not incur substantially greater transaction costs or reduced liquidity when entering into swaps under the Dodd-Frank Act's derivatives regulatory framework. A time requirement also would greatly reduce the availability of the exclusion for lender banks, particularly those banks that otherwise would not be designated as swap dealers based on their other derivatives activities.

While many commercial end user borrowers enter into interest rate swaps to fix their loan rates, they do not always choose to do so on or around the closing date. Some commercial end user borrowers execute their loans and related interest rate swaps at separate times due to the needs of their business. In these instances, a swap may be executed anywhere from several months in advance of the related loan's closing date to any time prior to the loan's maturity date.

Narrowly implementing the lending exclusion so that it only includes swaps entered into contemporaneously with a loan will result in higher borrowing costs for commercial end users. A timing requirement would force commercial end users to choose between entering into a swap on a date that the end user would otherwise deem unfavorable to its business or, in those instances where the lender bank is not a swap dealer and does not want to become one, to incur higher transaction costs by entering into a swap with an entity other than the lender bank. The higher costs imposed by the new entity could include, for example, a request for additional collateral as compared to the lender bank which in most cases structures the loan so that the underlying collateral also cross-collateralizes the related swap.

We understand the CFTC's desire for the lending exclusion to cover only those swaps that are connected to the financial terms of the loan. We urge the CFTC, however, to implement the lending exclusion in a manner that does not restrict a commercial end user from efficiently hedging its risk. For example, a commercial end user sometimes chooses to enter into an interest rate swap for less than the full duration of their loan and/or execute a second, new swap related to the original loan terms several years after the loan's closing date, with each case driven by the end user's business needs. We ask the CFTC to implement the lending exclusion so that it includes hedging swaps by

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[7] Capital One also proposes that the CFTC broaden the lending exclusion to include other extensions of credit such as investments and loans transacted through the U.S. Department of Treasury's New Market Tax Credit program, bond purchases and letters of credit. We refer the CFTC to the comment letter on the Proposed Rulemaking submitted by the Financial Services Roundtable that supports broadening the lending exclusion to include other extensions of credit.

commercial end users where the financial terms (*e.g.*, duration and principal amount) of a loan or other extension of credit do not exactly match the terms of the related swap.

If banks are not able to rely on the lending exclusion to provide partial hedging, anticipatory hedging and subsequent hedging swaps to their commercial banking customers, many banks will exit the market rather than register as a swap dealer. Commercial end users will be adversely impacted by the liquidity drain that will result if these banks halt offering such hedging swaps.

Limited Designation as a Swap Dealer

We believe the Commissions should allow all market participants, including financial institutions, to apply for a limited swap dealer designation for a particular business unit and for a particular swap category. It is likely that the swap activities of a broad range of banks, from the largest and most active dealer banks to some community banks, will be captured by the swap dealer definition. The operational and organizational structures that support swap activities will vary greatly among this diverse group of banks. In some cases, it would be less costly and less operationally burdensome for an entity to qualify certain business units for limited purpose designation by separating its dealing activities from its non-dealing activities rather than being subject to all regulatory requirements for all swaps entered into by such entity.

We strongly support the approach suggested by the Commissions, in a request for comment in the Proposed Rulemaking, that the limited swap dealer designation apply, on a provisional basis, at the time the entity makes an application for a limited designation.[8] The purpose of the limited designation would be defeated if an entity had to demonstrate that each of its business units complied with all requirements applicable to swap dealers at the time of registration.

Financial institutions and other market participants with limited dealing activities would incur greater operational costs if they were precluded from applying for a limited swap dealer designation at the time of registration. In other cases, community and regional banks would be forced to withdraw entirely from the swap market if all of Title VII's requirements were imposed on both dealing and non-dealing activities. If community and regional banks were to withdraw from the swap market, liquidity would be drained from the market and transaction costs would increase for commercial end users. If these same banks are permitted to apply for limited swap dealer designation relating only to dealing activities with their commercial banking customers, it is more likely they will be able to comply with Title VII's requirements and continue to offer swaps to their customers.

We encourage the Commissions to consider various factors when addressing requests for a limited swap dealer designation. One factor to consider is the overall complexity of an entity's dealing and non-dealing swap activities. Indicators of degree of

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[8] *See* 75 Fed. Reg. 80174 at 80182-83.

complexity that could be considered include the type or category and purpose of the swap. For example, a bank whose limited dealing activity consists of swaps with its commercial banking customers may find it less difficult to separate those activities from its other non-dealing activities as compared to an entity that actively makes markets in foreign exchange swaps, rate swaps, credit default swaps and other permitted derivatives.

The Commissions also could consider an entity's proportion of dealing activities to non-dealing activities. We believe those entities with a modest level of swap dealing activities as compared to their non-dealing activities should be allowed to elect a limited designation as a swap dealer. We propose an approach where an entity is automatically deemed eligible to choose a limited swap dealer designation covering its dealing activities if such entity's dealing activities do not exceed 50% of the entity's total swap activities, as measured by the notional amount of such swaps.

Once the Commissions have determined which entities are eligible for the limited swap dealer designation, we propose a framework that the Commissions could implement to clearly define which swap activities will be excluded from the swap dealer designation. We respectfully ask the CFTC to permit entities seeking a limited swap dealer designation to exclude all swap activities that are eligible for either the (i) lending exclusion from the swap dealer definition or (ii) the general exception from the swap dealer definition for swaps entered into for an entity's own account and not part of a regular business. This approach is inherently consistent with Congress' intent that the entire regulatory framework applicable to swap dealers should apply only to those swap activities that Congress intended to capture as dealer activities.

We also suggest important limitations that should be incorporated into this approach. Any swap dealer with aggregate swap positions that exceed the 50% percentage threshold, as discussed above, should not be permitted to seek a limited swap dealer designation. Also, if an entity subsequently exceeds these thresholds after previously being granted a limited swap dealer designation, its limited purpose designation may be revoked by the Commissions. These limitations are consistent with Congress' intent that all swap activities of the largest and most active dealers should be subject to regulation.

As the Commissions consider the eligibility for, and implementation of, the limited swap dealer designation, it is important to highlight that all swaps entered into by the non-swap dealer businesses of an entity with a limited swap dealer designation will remain subject to ongoing requirements that promote transparency and financial integrity of the derivatives market. These requirements include reporting of all swap transactions and, for financial entities, mandatory clearing and exchange trading.

Phased-In Compliance Periods

Based on the low *de minimis* thresholds as currently proposed, Capital One believes many entities will be required to register as swap dealers if they desire to continue their dealing activities, most of whom are not primary members of the

International Swaps and Derivatives Association.[9] Entities required to register as a swap dealer will vary greatly in their degree of market activity and presence, operational capability, information technology infrastructure and staffing. The requirements applicable to swap dealers as currently proposed, however, will apply equally to all swap dealers regardless of these differences. As a result, an entity that enters into a single interest rate swap with a notional amount of $105 million that is not connected to a loan or other extension of credit will be subject to all of the swap dealer requirements applicable to the largest and most active swap dealers, and on the same timeline for compliance.

Due to the enormous complexity and operational burden of these requirements, it is likely that some small swap dealers will be forced to exit the market because they cannot compete with large swap dealers with greater resources. If small swap market participants are forced to halt their activities, those end users who access the swap markets through these small market participants would suffer liquidity disruptions. Given the potential for these adverse market events and the diversity of the pool of potential swap dealers, we urge the Commissions to adopt an 18-month provisional registration period during which all registered swap dealers or major swap participants would be able to comply with a phase-in period for the substantive requirements of being a swap dealer or major swap participant.

In addition to a standard 18-month implementation period for all market participants, we also ask the Commissions to adopt a longer phase-in compliance period where the smallest and least risky swap dealers, regardless of status as a financial institution or amount of total assets, would be provided significantly more time to comply with the Commissions' rules applicable to swap dealers as compared to more active dealers with larger positions. This approach also permits the Commissions to initially focus their resources on those dealers who are critically important to the functioning of the swap markets and pose the greatest systemic risk from their activities. At the same time, smaller market participants would be afforded the necessary time and flexibility to identify infrastructure needs, build new systems, recruit additional staff and enhance existing operations.

The Dodd-Frank Act provides the Commissions with the authority to create a flexible implementation period, as they deem appropriate. We urge the Commissions to provide clarity on the compliance timeframes as soon as possible.

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[9] A list of the International Swaps and Derivatives Association's primary dealers is available at http://www.isda.org/membership/isdamemberslist.pdf.

Capital One appreciates the opportunity to comment on the Proposed Rulemaking. We welcome the opportunity to discuss any questions you may have on our comments. Feel free to contact me or Kenny Abramowitz, Head of Derivatives Marketing, at (212) 834-1371.

Sincerely,

Michael Slocum
Executive Vice President, Banking

cc: Federal Reserve Board of Governors

Office of the Comptroller of the Currency